

**DEPARTMENT OF AVIATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2002**



AUDIT SUMMARY

Our audit of the Department of Aviation for the year ended June 30, 2002, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in internal controls; and
- no instances of noncompliance with applicable laws and regulations that are required to be reported under Government Auditing Standards.

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AVIATION WORLD'S FAIR SUSPENDED

Background

The Aviation World's Fair 2003 was going to celebrate the one-hundredth-anniversary of the first powered and controlled flight of a manned machine by the Wright Brothers. Virginia and its partner, the state of North Carolina, planned to host this one-time event at the Newport News-Williamsburg International Airport in April 2003. Kallman Worldwide, incorporated as "Aviation World's Fair, Inc.," was organizing the event. Other organizations and agencies directly involved in the Aviation World's Fair 2003 included, but were not limited to: the Secretariats of Transportation, Commerce and Trade, and Natural Resources in Virginia, the North Carolina Aeronautics Council, Virginia jurisdictions and airports, and the staff and agents of federal, state, and local elected officials.

Grounds for Suspension

In October 2002, just five months before the scheduled event, the Commonwealth suspended all financial support for the Aviation World's Fair. The Commonwealth's decision to withdraw financial support for the event was supported by its discovery that the event planner was unable to reach minimum goals for advance ticket sales, unable to sign sponsors for the event, and unable to generate significant exhibitor revenues.

The event planner initially planned for \$1 million in paid visitors, \$18 million in corporate sponsorships, and 1,600 trade show exhibitors. Approximately one year before the scheduled event, the planner had no corporate sponsors and less than 100 exhibitor spots filled. The original plan was to begin selling tickets one year before the event. However, the event planner provided only non-refundable tickets to the public beginning in September 2002, just seven months before the event. In addition to the inability to meet these goals, the event planner was unable to secure a \$1 million performance bond to cover the cleanup costs for the project.

Contingent Liability

Aviation has a contingent liability associated with the cancellation of the Aviation World's Fair. Aviation paid the event planner \$1.5 million in accordance with the memorandum of agreement for duties performed. However, on November 22, 2002, the event planner requested additional reimbursement of approximately \$4.2 million under the memorandum of agreement which states that the event planner "shall be compensated for all work completed prior to termination, subject to the availability of funds, provided said work was previously scheduled on annual program plans and contracted for in discrete, particularized contracts." Aviation feels it has met its obligations under the memorandum of agreement and does not intend to make any further payments.

Status and Funding of the Project

Over the past two years in preparation for the Aviation World's Fair, Aviation participated in approximately \$27 million in permanent infrastructure improvements at the Newport News-Williamsburg International Airport supported by state, federal, and local funds. Aviation approved the airport's master plan that originally called for the construction of these improvements over a span of 10 to 20 years. The airport accelerated construction to serve site requirements of the Aviation World's Fair.

The Commonwealth decided to suspend financial support of the Aviation World's Fair before starting any temporary infrastructure projects because the event planner could not reach the minimum goals for advance ticket sales, sign any major sponsors for the event, or generate significant exhibitor revenues. The

temporary infrastructure projects were specifically necessary for the Fair, such as fencing, parking, roadways, and walkways.

Aviation used various sources to finance the Commonwealth's share of the capital project. During fiscal year 2001, Aviation began seeking authorization to borrow \$15 million from the Virginia Resource Authority to cover the Commonwealth's share of the projects scheduled at Newport News. The Department of Accounts approved a Treasury Loan of \$7,392,822 for Aviation to use as interim financing while waiting for General Assembly approval of long term financing through the Resource Authority. A stipulation of the Treasury loan was to reserve funds equivalent to the loan amount. Given this stipulation in fiscal year 2002, Aviation decided to cancel the Treasury loan and use the funds it was required to reserve in the Commonwealth Airport Funds and Aviation Special Funds for the improvements.

Meanwhile Aviation still awaited the approval of the \$15 million loan from the Resource Authority. Aviation anticipated using the loan proceeds to replenish \$4.4 million in Aviation Special Funds and \$3.0 million in Commonwealth Airport Funds. In February 2002, the General Assembly approved a loan amount of only \$6.6 million. The loan amount was far short of the requested amount of \$15 million. As a result, Aviation was unable to replenish its special funds and had to delay funding originally allocated to other local airports.

Upon completion of the Newport News-Williamsburg International Airport project, Aviation will have granted a total of \$12.5 million on the project, with Peninsula Airport Commission contributing \$2.9 million and the Federal Aviation Administration contributing \$13 million.

AGENCY BACKGROUND AND FINANCIAL HIGHLIGHTS

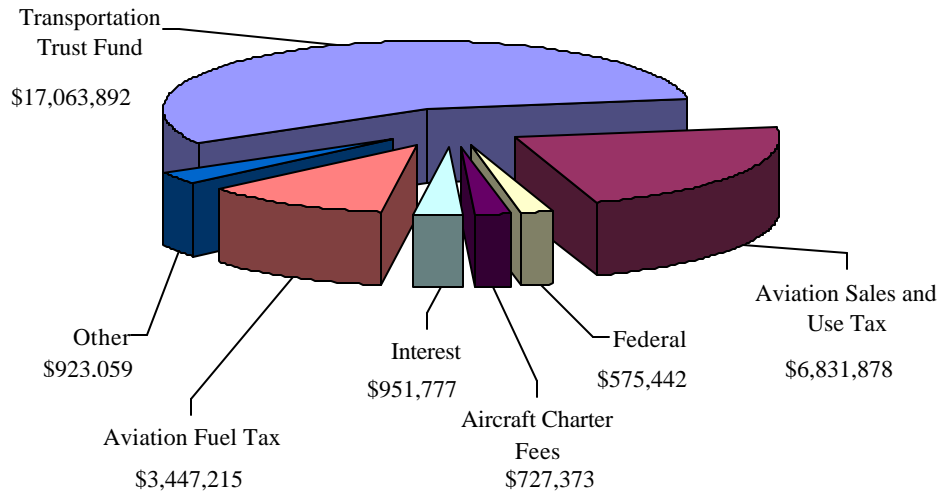
The Department of Aviation is a state transportation agency along with the Department of Transportation, Department of Motor Vehicles, Department of Rail and Public Transportation, Motor Vehicle Dealer Board, and Virginia Port Authority.

Aviation provides financial and technical assistance to eligible sponsors for the planning, development, promotion, construction, and operation of airports and aviation facilities. It administers applicable provisions of the Code of Virginia, plans for the development of a state aviation system, promotes aviation, and licenses aircraft, airports, and landing areas. Aviation also provides air transportation services to the Governor, the Legislature, and state agencies.

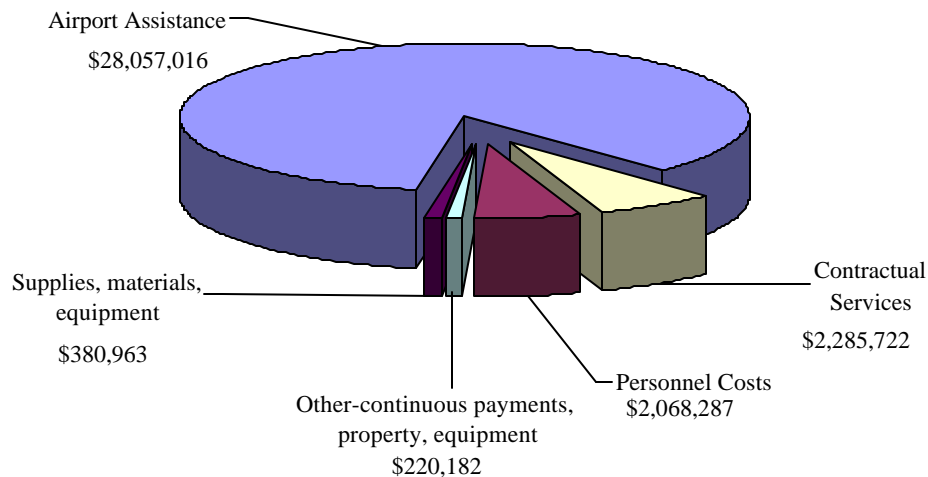
Aviation does not own or operate airports; they provide financial assistance to Virginia airports through grants. Aviation receives the majority of its funding from the Commonwealth Transportation Trust Fund. The Commonwealth Transportation Board allocates 2.4 percent of the fund's revenues to the Commonwealth Airport Fund. Aviation's other primary revenue sources are aviation fuel taxes and Virginia aircraft sales and use taxes. The majority of its expenses are for airport assistance.

The following charts depict the revenues and expenses for fiscal year 2002:

FY 2002 Revenues



FY 2002 Expenses



Commonwealth Airport Fund

The Commonwealth Airport Fund accounts for Aviation's share of the Commonwealth's Transportation Trust Fund revenues. By statute, Aviation must commit 40 percent of the funds as entitlement payments to air carrier airports, 40 percent to air carrier reliever airports on a discretionary basis, and 20 percent to general aviation airports on a discretionary basis. Air carrier airports, with the exception of those owned or leased by Metropolitan Washington Airport Authority, receive an allocation of funds based upon

the percentage of enplanements for each airport to total enplanements at all carrier airports, with a maximum of \$2 million and a minimum of \$50,000 per year. Air carrier reliever airports and general aviation airports must apply for discretionary funds. Aviation evaluates, prioritizes, and submits recommendations for the discretionary funds to the Virginia Aviation Board for final revision and approval. The Aviation Board allocates the discretionary funds and carries forward any uncommitted funds from the current fiscal year to the next fiscal year for future projects.

Aviation Special Fund

The Special Fund includes collections by the Department of Motor Vehicles for aviation fuel taxes, the Department of Taxation for aircraft sales and use taxes, Aviation for various fees, and interest earned on these funds. These revenues pay Aviation's administrative expenses and provide funding for airport maintenance, facilities and equipment, promotion, air service development, and airport system planning, regulation, safety, and aircraft operations.

AIRPORTS REVOLVING LOAN FUND

The Airports Revolving Loan Fund (ARLF) Program was created to help provide a low-interest source of funds to assist publicly owned, public-use airport sponsors with capital projects that could not be financed with grants-in-aid from the Commonwealth Airport Fund. The Virginia Resource Authority administers the loan program and is the custodian. The Virginia Aviation Board makes a recommendation to the Resource Authority for each loan request Board's project eligibility criteria. Among other things, the Resource Authority considers the Aviation Board's recommendation and the creditworthiness of the applicant when evaluating loan applications.

ANNUAL AVIATION CONFERENCE

The Department of Aviation is a participating sponsor of the annual Virginia Aviation Conference. The main purpose of the annual Aviation Conference is to allow local airports to request funding from the state, to provide participants information concerning requirements in obtaining federal funding, and to provide participants with information concerning aviation, i.e. new laws and problems encountered by airports and the resolutions. The other sponsors of the conference include Virginia Aviation Board, Virginia Airport Operators Council, and Virginia Aviation Business Association and attendees.

Aviation acts as the fiscal agent and is responsible for handling the administrative duties of the conference, which involves collecting and depositing money for the conference, paying vendors, as well as preparing a financial recap of the conference. Aviation pays for the rental of booth space for its own display, as well as registration and travel expenses for all of its employees attending the conference. Aviation does not record the financial activities regarding the annual aviation conference on the Commonwealth's Accounting and Reporting System. Annual revenues and expenses for the conference range from \$50,000 to \$60,000.

BUDGET REDUCTIONS

Aviation's budget reductions for fiscal year 2002 were minimal. Special revenue funds used for administration and general funds were reduced three percent or \$21,680 and \$1,500, respectively. Budget cuts for fiscal year 2003 will be more significant. Aviation plans to absorb these cuts through reduced funding to airports for maintenance, facilities, equipment, capital projects, and other cuts in various operating programs.

February 19, 2003

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Aviation** for the year ended June 30, 2002. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of Aviation's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of Aviation's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Allocations	Expenditures
Revenues	Fixed Assets

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether Aviation's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

Aviation's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable,

but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that Aviation properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. Aviation records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

We discussed this report with management on March 12, 2003.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF AVIATION
Richmond, Virginia

As of June 30, 2002

Charles S. MacFarlane, Director

AVIATION BOARD MEMBERS

George P. Ramsey III, Chairman

John G. Dankos, Jr.	Jeanne H. Pedigo
John V. Mazza, Jr.	Joseph H. Ritchie
Robert H. Neitz	William H. Smith

Emmitt F. Yeary